S&P Global
Ratings

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South Carolina Public Service Authority; Retail Electric

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Credit Highlights

- S&P Global Ratings affirmed its 'A-' rating on the South Carolina Public Service Authority's (Santee Cooper or the authority) combined utility revenue debt.
- The outlook is negative.

Security

The bonds are secured by a net revenue pledge of the combined utility, which includes electric and water services. The electric system comprises 98% of pledged revenue. The authority had $7.2 billion in debt outstanding as of Dec. 31, 2022.

Credit overview

The rating reflects:

- The authority's limited financial flexibility while operating under a rate freeze stemming from settlement of litigation (the Cook settlement) related to its failed VC Summer nuclear project;
- A disruption to Santee Cooper's coal supply, which led to significant unbudgeted power costs in fiscal 2022; and
- Coverage of debt service requirements that was significantly below 1.0x in 2022, which the authority bridged by drawing on its $1 billion in lines of credit.

We affirmed the 'A-' rating in consideration that there is a pathway, beginning in 2025, to recover a large portion of the unbudgeted costs, via exceptions to the Cook settlement rate freeze.

However, our negative outlook reflects:

- The possibility that this pathway could be eliminated, should litigation result in a court ruling that denies the applicability of the exceptions to the rate freeze, severely limiting Santee Cooper's ability to pass on to ratepayers the unbudgeted costs; and

- Because there is the possibility of further financial stress despite power costs being largely hedged for the remainder of 2023 and for 2024, and an inability to recover these costs until the rate freeze expires.

The 'A-' rating further reflects our opinion of the following:

- A deep and diverse service area and customer base spans much of South Carolina. Santee Cooper serves about 1 million end-use customers--approximately 20% directly and 80% indirectly--through its sales to Central Electric Power Cooperative (Central). Central accounts for 55% of the authority's revenue.
- Rates are competitive, and the authority's relative market position has improved while operating under the rate freeze. However, we anticipate sizable base and fuel rate increases in 2025 (and smaller annual rate increases thereafter); moreover, as the authority pursues recovery of the Cook exceptions, additional rate increases will likely be imposed over a currently undetermined period.
- On an accrual basis, fixed cost coverage (FCC) averaged 1.28x during fiscal years 2019-2021, but FCC was just 0.5x on a cash basis in fiscal 2022, as Santee Cooper was unable to recover the Cook settlement exceptions due to the rate freeze. Management projects financial results that we calculate would produce improving cash-basis FCC--1.1x and 1.2x, respectively, in fiscal years 2023 and 2024--prior to the authority regaining its rate-setting autonomy and recovering Cook exceptions over a to-be-determined period.
- Liquidity is solid. The authority had $956 million (net of collateral) cash, available cash, and investments plus undrawn capacity on credit lines at fiscal year-end 2022, covering about 249 days of operating expenses. Although this is projected to decline to about $750 million by fiscal year-end 2024, we expect that it would remain supportive of the current rating.
- In the wake of the stranded investment in the cancelled nuclear project, Santee Cooper's power supply plans, as outlined in its 2023 integrated resource plan (IRP), are designed to maintain system reliability while transitioning its coal-dependent power supply to a cleaner, more efficient, more flexible, and more diverse resource portfolio. We generally view these plans as credit supportive, but we also believe that there is a degree of execution risk in pursuing them, and we view them as a key to Santee Cooper's effort to control costs.
- Santee Cooper is a moderately leveraged utility, with debt measuring 77% of total capitalization. We expect this ratio will remain at about this level through 2028, despite the planned issuance of $2.4 billion in additional debt to fund the authority's $3.5 billion capital plan over fiscal years 2024-2028, in support of the IRP.

Environmental, social, and governance

We believe Santee Cooper faces environmental risks that are moderately credit negative. The authority's effort to reduce its carbon footprint was complicated by the cancellation of the V.C. Summer nuclear units 2 and 3 (VCS2&3) project, and the utility faces exposure to regulation of fossil fuel emissions. Coal-fired generation in 2022 was relatively low (37% of energy) by historical standards, due to disrupted coal deliveries that contributed to greater reliance on power purchases and the higher dispatch of the authority's gas units. Management expects coal-fired generation will increase to 65% of energy in 2025. We also note that the authority faces several hundred million dollars in coal ash pond closure costs at its Cross and Winyah stations.

The authority's IRP anticipates the retirement of its 1,150 megawatt Winyah coal plant, and the addition of a substantial amount of gas-fired generation (both combined and simple cycle), solar, and battery storage. The authority projects that its natural gas units will account for 38% of its energy needs by 2040, followed by sustainable resources (28%), and coal (23%). Therefore, we anticipate that Santee Cooper will be able to lower carbon intensity over the next decade. Although the authority is also exposed to risk of hurricanes, its broad service area mitigates this risk.

In our view, social risks are credit negative. We anticipate significant rate increases once the rate freeze expires and believe that this will result in higher rates and a weaker market position relative to that of peers. Following stronger-than-expected U.S. economic growth through the third quarter of 2023, S&P Global Economics believes that recent business and consumer activity are not sustainable and projects slowing economic activity in the fourth quarter of 2023, along with tepid economic growth of 1.3%-1.4%, respectively, in 2024-2025. (See "Economic Outlook U.S. Q4 2023: Slowdown Delayed, Not Averted," published Sept. 25, 2023, on RatingsDirect). Although inflation is softening, S&P Global Economics projects elevated interest rates through 2024. Consequently, we continue to monitor the strength and stability of public power utilities' revenue streams for evidence of delinquent payments or other revenue erosion. We note that despite below-average incomes, delinquencies have not been meaningful from a credit perspective. Nevertheless, we believe that Santee Cooper has limited financial flexibility to absorb future pressures, as the authority will be operating under the rate freeze through Jan. 15, 2025.

We believe that governance risk is a credit negative compared with that of peers, given significant turnover of executive management, the constraints of operating under a rate freeze, and the need to jointly conduct resource planning with Central--with such plans subject to public service commission approval.

Outlook

The negative outlook continues to reflect our forward-looking view of weak coverage metrics on a cash basis through the end of the rate freeze. Although we note that commodity cost pressures eased in 2023--and that they are largely hedged for the remainder of 2023 and into 2024--there remains the potential that actual demand exceeds budgeted demand, and that cost pressures might return. As the authority has limited ability to respond to unbudgeted cost pressures due to the ongoing rate freeze, this exposure underpins the negative outlook.

The negative outlook also reflects the potential for disallowance of the Cook settlement exceptions, which would challenge the authority's ability to ultimately recover unbudgeted costs incurred during the current rate freeze. This could have a negative effect on the authority's liquidity and/or capital spending plans.

Downside scenario

We could lower the rating if there are significant unbudgeted power costs through the remainder of the rate freeze period, challenging the authority's ability to effectively respond to further pressures on financial margins, coverage ratios, and liquidity (beyond levels currently estimated), and its ability to currently fund capital spending plans.

We could also lower the rating, potentially by multiple notches, if there is an adverse ruling on the Cook settlement exceptions, challenging the authority's ability to recover a substantial portion of its unbudgeted costs. Finally, we could lower the rating if the authority is unable to execute on its plans to remake its power supply (which we view as key to controlling costs and flexibility), whether because of deferred capital spending, or the requirement that the authority obtain legislative approval as a precondition to accessing capital markets.

Upside scenario

Given the authority's limited financial flexibility while operating under the rate freeze, and uncertainty related to the potential challenge to the Cook settlement exceptions, we do not anticipate raising the rating or revising the outlook to stable during the next two years.

Credit Opinion

Our previous rating action

In July 2022, we lowered our rating on Santee Cooper's debt to 'A-' from 'A' and maintained our negative outlook, which had been revised from stable earlier in the year. The July 2022 rating action (and subsequent affirmation in September 2022) reflected our expectation of weakened coverage metrics in fiscal 2022, stemming from the authority's inability to pass through to wholesale and retail customers the vast majority of hundreds of millions of dollars in unbudgeted fuel and purchased power costs. The inability to recover these costs was due to an ongoing rate freeze (through Jan. 15, 2025), imposed under terms of the 2020 Cook litigation settlement.

The unbudgeted fuel and power costs stemmed from a fire at the authority's largest and lowest-cost coal supplier, cutting Santee Cooper's coal deliveries from that supplier in half, prompting the authority to dispatch its higher-cost gas units (at a time when gas prices were rising) and rely on more expensive power purchases to conserve its coal pile. Santee Cooper subsequently contracted with alternate coal suppliers, but at substantially higher prices. The bulk of the authority's budgeted gas needs were hedged, but the shift in dispatch and higher energy demand drove up day-ahead and real-time power purchases, which were not hedged.

Cook settlement exceptions

Under the terms of the Cook settlement, Santee Cooper can defer to rates charged in years after the rate freeze period just and reasonable costs and expenses incurred during the rate freeze period directly resulting from certain circumstances, referred to as permitted exceptions, or Cook exceptions, which generally include force majeure type events, changes in law, and deviations in Central's load of plus or minus 4%.

The authority has identified substantial costs that it believes are exceptions to the rate freeze (as provided for in the Cook settlement), and that could provide a pathway to recover a large portion of the unbudgeted expenses, replenishing liquidity. The authority has filed for $490 million in exceptions for 2020-2022, with about $325 million related to the fire at a mine belonging to the authority's primary and lowest-cost supplier of coal. As the mine fire disruption has continued through 2023, Santee Cooper expects to file for additional exceptions.

These exceptions are not recoverable until after the rate freeze ends, and then only if they survive legal challenge. Importantly, the exceptions could be subject to an audit if requested by a party and granted by the court, and disallowance would pose a risk to ultimate recovery of these costs. However, we note that once the rate freeze ends, and assuming no adverse legal ruling in the interim, Santee Cooper will be able to recover costs even as the case makes its way through the legal process.

Indeed, on Sept. 9, 2022, Cook settlement class counsel filed a motion requesting that the court rule on the applicability of the rate freeze exceptions. On Sept. 26, the court denied the motion, noting that insofar as the rate freeze is in effect, consideration at this time was premature. In the ruling, and in reference to the mine fire exceptions, the judge's ruling states that "Although the court will refrain from determining the applicability of this particular exception, I note that nothing in the language of the settlement agreement that limits the fire exception to Santee Cooper-owned property".

Although we take this as an indication of how the court might, in the future, interpret the applicability of the mine fire exceptions, the dismissal of the motion is not itself a ruling on the applicability of the mine fire exception. Therefore, we anticipate that the court may well revisit this later, and we believe that an adverse ruling that disallows a large portion of the exceptions would greatly hamper the authority's ability to recover these costs, bolster liquidity, or currently fund substantial capital expenses.

Financial metrics

The authority's 2022 financial metrics were adversely affected by the coal supply disruption; higher gas and power costs; and an inability to pass through higher costs on a timely basis to ratepayers due to the rate freeze agreed upon in the Cook settlement, associated with the cancelled VCS2&3 project.

Santee Cooper is accounting for a portion of the Cook exceptions as a regulatory asset, which resulted in 1.2x accrual-based debt service coverage (DSC) for 2022. However, the establishment of a regulatory asset is a non-cash accounting treatment that defers recognition of the costs, but not the obligation to fund them. Consequently, our rating is more reflective of Santee Cooper's 0.4x cash-basis coverage of 2022 debt service requirements, and 0.5x cash-basis coverage of fixed costs.

On the strength of lower gas and power prices, management expects improved DSC for 2023. Based on actual results through July, and estimates and projections through the end of the year, the authority projects 1.2x DSC on a cash basis; we estimate FCC at 1.1x on a cash basis. Projections for 2024 suggest modest further strengthening of coverage metrics.

Excluding collateral holdings, the authority had $993 million in available liquidity at fiscal year-end 2022, representing 259 days of operating expenses. This was down from $1.2 billion (355 days of 2021 operating expenses), as Santee Cooper used a combination of unrestricted cash and draws on its liquidity facilities to cover unbudgeted expenses until it can collect these from ratepayers (as exceptions) after the rate freeze expires.

The authority projects total liquidity of $804 million (212 days of operating expenses) at fiscal year-end 2023. Projections for 2024 suggest weaker liquidity, measuring an estimated 191 days of operating expenses, which we nevertheless believe will continue to support the current rating.

In our opinion, projections for 2025 and beyond are not currently meaningful, as the authority has not yet determined the period over which it will seek to recover the exceptions; such determination will likely have a significant influence on coverage and liquidity metrics.

When the rate freeze ends…

Santee Cooper has not raised its retail customer base rates since 2017 and has been unable to adjust fuel rates or prices to Central since the rate freeze was imposed in 2020.

Based on management's forecast, we anticipate a moderately large base plus fuel rate increase when the rate freeze expires in 2025. However, we also anticipate that Santee Cooper will begin recovering the Cook exceptions, but we note that management has not determined the period over which it will do so. In our view, an attempt to recover the exceptions over a relatively short time would result in very large rate increases during that period, suggesting the potential for rate shock.

Public Service Authority of South Carolina, South Carolina--Key credit metrics

	--Fiscal year ended Dec. 31--		
	2022	**2021**	**2020**
Operational metrics			
Electric retail customer accounts*	204,801	198,725	193,930
% of electric retail revenues from residential customers	26	31	39
Top 10 retail electric customers' revenues as % of total electric operating revenue	18	13	N.A.
Service area median household effective buying income as % of U.S.	87	88	87
Weighted average retail electric rate as % of state	87	87	88
Financial metrics			
Gross revenues ($000s)	1,604,865	1,775,563	1,638,295
Total operating expenses less depreciation and amortization ($000s)	1,400,937	1,237,211	1,018,691
Debt service ($000s)	418,463	423,545	454,272
Debt service coverage (x)§	0.4	1.3	1.4
Fixed-charge coverage (x)§	0.5	1.2	1.3
Total available liquidity ($000s)†	992,851	1,203,942	984,642
Days' liquidity	259	355	353
Total on-balance-sheet debt ($000s)	7,223,997	6,785,860	6,816,498
Debt-to-capitalization (%)	77	76	76

* The authority also sells power to Central Electric Cooperative, S.C., whose 18 member distribution cooperative members serve about 800,000 additional retail customers. § Debt service coverage and fixed charge coverage figures for 2022 exclude non-cash regulatory assets associated with Cook Settlement exceptions, which are not recoverable until the rate freeze expires, post-2024. Debt service coverage -- Revenues minus expenses, divided by debt service. Fixed-charge coverage -- Sum of revenues minus expenses minus total net transfers out plus capacity payments (or their proxy), divided by the sum of debt service plus capacity payments (or their proxy). † Total available liquidity excludes collateral posted by counterparties, and held by the authority. Liquidity includes available committed credit line balances, divided by operating expenses net of depreciation. N.A. -- Not available.

Related Research

- Through The ESG Lens 3.0: The Intersection Of ESG Credit Factors And U.S. Public Finance Credit Factors, March 2, 2022

Ratings Detail (As Of November 10, 2023)

South Carolina Pub Svc Auth retail elec		
Long Term Rating	A-/Negative	Affirmed

Ratings Detail (As Of November 10, 2023) (cont.)		
South Carolina Pub Svc Auth retail elec		
Unenhanced Rating	A-(SPUR)/Negative	Affirmed
South Carolina Pub Svc Auth retail elec (AGM)		
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South Carolina Pub Svc Auth retail elec (AGM) (SECMKT)		
Unenhanced Rating	A-(SPUR)/Negative	Affirmed
South Carolina Pub Svc Auth retail elec (AMBAC)		
Unenhanced Rating	A-(SPUR)/Negative	Affirmed
South Carolina Pub Svc Auth retail elec (ASSURED GTY)		
Unenhanced Rating	A-(SPUR)/Negative	Affirmed

Ratings Detail (As Of November 10, 2023) (cont.)		
South Carolina Pub Svc Auth retail elec (BAM) (SECMKT)		
Unenhanced Rating	A-(SPUR)/Negative	Affirmed
South Carolina Pub Svc Auth retail elec (BAM) (SECMKT)		
Unenhanced Rating	A-(SPUR)/Negative	Affirmed
South Carolina Pub Svc Auth retail elec (BAM) (SECMKT)		
Unenhanced Rating	A-(SPUR)/Negative	Affirmed
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Unenhanced Rating	A-(SPUR)/Negative	Affirmed

Ratings Detail (As Of November 10, 2023) (cont.)		
South Carolina Pub Svc Auth retail elec (BHAC) (SECMKT)		
Unenhanced Rating	A-(SPUR)/Negative	Affirmed
South Carolina Pub Svc Auth retail elec (MBIA) (National)		
Unenhanced Rating	A-(SPUR)/Negative	Affirmed
South Carolina Pub Svc Auth retail elec (National)		
Unenhanced Rating	A-(SPUR)/Negative	Affirmed
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Unenhanced Rating	A-(SPUR)/Negative	Affirmed
South Carolina Pub Svc Auth retail elec (National)		
Unenhanced Rating	A-(SPUR)/Negative	Affirmed
South Carolina Pub Svc Auth retail Elec (BAM) (SECMKT)		
Unenhanced Rating	A-(SPUR)/Negative	Affirmed

Many issues are enhanced by bond insurance.